

Recent Issues related to the JFTC Report

- ✓ Seller needs to explain the “necessity and reasonableness” to justify the “foreclosure effects” of destination restrictions and profit sharing clauses, regardless of FOB or DES.
- ✓ The JFTC Report is not merely a guideline of the Antimonopoly Act of Japan.
- ✓ The Antimonopoly Act of Japan and the JFTC Report are applicable to and enforceable against Sellers outside Japan.

July 2019

Hiroyasu Konno

“Basic understanding” in the JFTC Report

“Regardless of FOB or DES, destination restrictions and a profit sharing clause have ‘foreclosure effects.’”

Regardless of FOB or DES, the JFTC Report states as follows in “(1) Basic understanding” concerning destination restrictions:

When a seller under a fixed-term contract prevents a buyer from reselling LNG by means of imposing destination restrictions which tend to cause a situation where new entrants’ trading opportunities are lessened in these markets, such conduct is deemed to have “**foreclosure effects**”, and is, in principle, in violation of the Antimonopoly Act.

Regardless of FOB or DES, the JFTC Report states as follows in “(1) Basic understanding” concerning profit sharing clauses:

It is considered that profit share clauses under a fixed-term LNG contract prevent Japanese users from reselling LNG to other users practically and indirectly. When a seller prevents a user from reselling LNG by means of imposing profit share clauses which generate **foreclosure effects**, such clauses are in violation of the Antimonopoly Act.

“Tendency” is sufficient for “foreclosure effects” to be recognized.

The JFTC Report states as follows in its explanation about “foreclosure effects”:

[I]mposing destination restrictions which tend to cause a situation where new entrants’ trading opportunities are lessened in these markets ... is deemed to have “foreclosure effects.”

It does NOT state as follows:

[I]mposing destination restrictions which cause a situation where new entrants’ trading opportunities are lessened in these markets ... is deemed to have “foreclosure effects.”

Therefore, regardless of FOB or DES, in order for destination restrictions and/or profit sharing clauses to be deemed to have “foreclosure effects,” and to be, in principle, in violation of Antimonopoly Act, “tendency to cause a situation where new entrants’ trading opportunities are lessened in these markets” is sufficient.

“Actually causing a situation where new entrants’ trading opportunities are lessened in these markets” is NOT necessary.

Seller needs to explain the “necessity and reasonableness” to justify the “foreclosure effects” of destination restrictions and profit sharing clauses

As recognized in the JFTC Report, regardless of FOB or DES, it is self-evident that destination restrictions and profit sharing clauses tend to cause a situation where new entrants’ trading opportunities are lessened in LNG markets. This means that, regardless of FOB or DES, destination restrictions and profit sharing clauses are deemed to have “foreclosure effects”, and are, in principle, in violation of the Antimonopoly Act.

Therefore, Seller needs to explain to Buyer the “necessity and reasonableness” to justify the “foreclosure effects” that destination restrictions and profit sharing clauses have, in order for them to be exceptionally legal.

Seller’s failure of or withholding explanation of the “necessity and reasonableness” to justify such “foreclosure effects,” can even constitute violation of the Antimonopoly Act.

Seller's withholding explanation can even constitute a violation of the Antimonopoly Act

Regardless of FOB or DES, the following Buyer's conducts can mean Buyer's leaving the unjustified "foreclosure effects" of destination restrictions and profit sharing clauses:

- ✓ Withholding consent to Buyer's diversion request without explaining any concrete "necessity and reasonableness" to justify the "foreclosure effects" of the destination restrictions.
- ✓ Withholding consent to Buyer's diversion request by mixing this matter with other commercial negotiations which cannot justify the "foreclosure effects" of the destination restrictions.
- ✓ Requesting Buyer to share the profit without explaining any concrete "necessity and reasonableness" to justify the "foreclosure effects" of the profit sharing clauses, e.g., failure to explain the concrete "unquantifiable risks" additionally incurred by Seller resulted from the diversion in DES SPA.
- ✓ Refusing the removal of profit sharing clauses by mixing this matter with other commercial negotiations which cannot justify the "foreclosure effects" of the profit sharing clauses.

These conducts can even constitute a violation of the Antimonopoly Act.

The JFTC Report is more advanced than mere guidelines of the Antimonopoly Act

The JFTC Report is not a law or regulation. And yet, it is not merely a guideline of the Antimonopoly Act.

Since it is based on the fact findings covering approximately 96% of all Buyers importing LNG into Japan and approximately 95% of all Sellers exporting LNG to Japan, which are acknowledged by the JFTC's statutory investigation pursuant to Article 40 of the Antimonopoly Act, the JFTC Report shows not only its interpretations of the Antimonopoly Act but also its views on the application of the Antimonopoly Act to destination restrictions and profit sharing clauses.

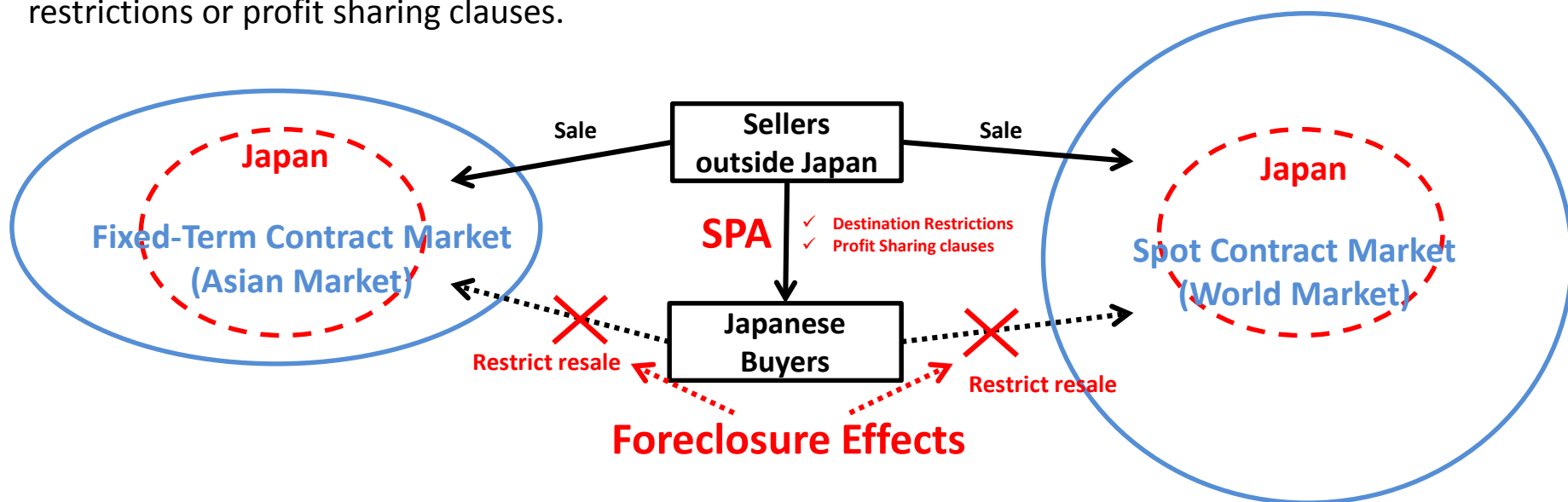
Noncompliance with the JFTC Report can be more easily recognized as a violation of the Antimonopoly Act, once the JFTC launches its procedures for each specific case.

Neglecting the JFTC Report, believing that “the JFTC Report is not a law or regulation, and is just a research report,” is not advisable.

Applicability of the Antimonopoly Act of Japan and the JFTC Report

The Japanese LNG market is part of the Asian fixed-term contract market (Asian market) and the world spot contract market (World market) both of which are recognized in the JFTC Report (“Global LNG Markets”). The “foreclosure effects” on the Global LNG Markets means those effects on the Japanese LNG market, too.

Therefore, as long as destination restrictions or profit sharing clauses in SPAs have “foreclosure effects” on the Global LNG Markets, they are in violation of the Antimonopoly Act of Japan, regardless of the governing law of the SPA or nationality of the Sellers, unless Seller succeeds in explaining the “necessity and reasonableness” to justify the “foreclosure effects” of the destination restrictions or profit sharing clauses.



Neglecting the JFTC Report, believing that “the Antimonopoly Act of Japan and the JFTC Report are not applicable to Sellers outside Japan,” is not advisable.

Enforceability of the Antimonopoly Act of Japan and the JFTC Report

During the press conference held on the day when the JFTC Report was released, the Secretary General of the JFTC made comments to the effect that:

- ✓ The JFTC acknowledges that most Sellers exporting LNG to Japan are outside Japan; and
- ✓ Since the content of the JFTC Report should be publicized thoroughly to the Sellers outside Japan, the JFTC created the English Translation of the JFTC Report and is ready or eager to make a presentation to introduce and explain the JFTC Report in international conferences.

Obviously Secretary General assumes in the above comments that the Antimonopoly Act of Japan and the JFTC Report is applicable to and enforceable against the Sellers outside Japan.

Neglecting the JFTC Report, believing that “the Antimonopoly Act of Japan and the JFTC Report are not enforceable against Sellers outside Japan,” is not advisable.

Suggestion of follow-up investigations by the Advisory Committee for Natural Resources and Energy

The draft report dated June 2019 of a group of the Advisory Committee for Natural Resources and Energy* which is appeared on the website of METI of Japan states as follows:

To further promote flexibility of LNG market, it is and will be important to disseminate the JFTC Report which is related to Destination Restrictions, Profit Sharing Clauses, and Take or Pay. For this purpose, . . . **follow-up investigations to see achievements should be implemented as needed.**

* Advisory Committee for Natural Resources and Energy is the committee the opinions of which Minister of Economy, Trade and Industry is required to hear when he/she formulates a draft of the Basic Energy Plan and seek a cabinet decision thereon pursuant to Article 12, 3 of Basic Act of Energy Policy of Japan.

More serious compliance with the JFTC Report is advisable.

Thank you for your attention.

If you have any questions, please feel free to contact me.

Hiroyasu Konno

Attorney-at-law admitted in Japan and New York

Nishimura & Asahi (<https://www.jurists.co.jp/>)

Email: h_konno@jurists.co.jp